



**SOUTH DAKOTA RETIREMENT SYSTEM,
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN,
AND SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

**INDEPENDENT AUDITORS' REPORTS
ON AUDITS OF FINANCIAL STATEMENTS
for the year ended June 30, 2010**



**SOUTH DAKOTA RETIREMENT SYSTEM,
SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN, AND
SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

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Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System (SDRS) as of June 30, 2010, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of SDRS's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements present only the financial position and changes in financial position of the State of South Dakota that is attributable to SDRS. They do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2010, and the changes in its financial position and its cash flows, where applicable, for the fiscal year then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System as of June 30, 2010, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

As explained in note 2 to the financial statements, the financial statements include investments valued at \$2,090,112,054 (32% of net assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2010 on our consideration of SDRS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 3 through 6, the schedule of funding progress, and schedule of employer contributions on page 26 are not a required part of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of administrative expenses and investment activity expenses on pages 27 and 28 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

Omaha, Nebraska
November 22, 2010

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2010

This section presents management's discussion and analysis of the South Dakota Retirement System's (SDRS or the System) financial position and performance as of and for the year ended June 30, 2010. This section is intended to supplement the SDRS financial statements and should be read in conjunction with the remainder of the SDRS financial statements.

Financial Highlights

- The plan net assets of SDRS increased by \$847.9 million during fiscal year 2010. This increase was primarily due to the investment performance of 18.7%, which was significantly above the assumed rate of 7.75%.
- SDRS funded ratio increased to 96.3% in 2010 from 91.8% in 2009.
- SDRS paid \$326.0 million to benefit recipients in fiscal year 2010 compared to \$306.8 million in 2009. SDRS received \$195.3 million in member and employer contributions in fiscal year 2010 compared to \$189.7 million in 2009.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The System presents the statement of the plan net assets as of June 30, 2010 and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of the year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules. Information in the notes provides disclosures concerning SDRS's organization, contributions and reserves, investments, the use of derivatives and securities lending, and other information.

Supplemental Information

In addition to this discussion and analysis, the supplemental information also consists of two schedules of trend data and related notes concerning the funded status of SDRS and employer contributions.

Other supplementary schedules include detailed information on administrative expenses incurred by SDRS and a breakout of investment manager fees.

Financial Analysis

SDRS is a cost-sharing, multiple-employer public employee retirement system. SDRS provides retirement, disability, and survivor benefits for employees of the state of South Dakota and its political subdivisions. The benefits are funded through member and employer contributions and investment income.

SDRS benefits are based on the members' final average compensation, their years of credited service, and a benefit multiplier and are payable for life with a 60% survivor benefit.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2010

A summary of the plan net assets is shown below:

Summary of Plan Net Assets

June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets:		
Cash and cash equivalents	\$ 6,180,991	5,308,826
Receivables	23,367,973	28,262,118
Investments, at fair value	6,563,362,061	5,676,926,340
Other assets	46,680	47,810
Total assets	<u>6,592,957,705</u>	<u>5,710,545,094</u>
Liabilities:		
Accounts payable and accrued expenses	2,649,600	2,538,567
Securities sold, but not yet purchased	78,940,680	52,023,535
Unsettled investment purchases	13,804,034	6,991,033
Due to brokers – futures transactions	928,402	224,813
Total liabilities	<u>96,322,716</u>	<u>61,777,948</u>
Net assets held in trust for pension benefits	<u>\$ 6,496,634,989</u>	<u>5,648,767,146</u>

Funded Ratio

The funded ratio is an actuarial measure of funding progress and soundness for SDRS based on the actuarial accrued liability measurement of liabilities. The ratio is equal to the actuarial value of assets divided by the actuarial accrued liabilities. A ratio in excess of 100% would indicate that the actuarial accrued liability is fully funded.

The actuarial value of assets is equal to the net actuarial value of assets plus the reserve of funding of long-term benefit goals. The net actuarial value of assets is credited each year with the assumed rate of investment return and debited or credited with the SDRS liability gain or loss for the year. The resulting actuarial value of assets is constrained to a range of 80% to 120% of the market value of assets, and the reserve for funding of long-term benefit goals is adjusted if these limits apply.

The actuarial accrued liability is the present value of all benefits currently being paid and expected to be paid in the future, to all members, less the present value of future normal cost contributions.

	<u>2010</u>	<u>2009</u>	<u>Change</u>
Funded ratio	96.3%	91.8%	4.5%

Change in Plan Net Assets

Additions to the plan net assets include member and employer contributions and net investment income (loss). The fixed member and employer contribution rates are established by law. On an annual basis, an independent

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2010

actuarial valuation of SDRS is made to determine the adequacy of the fixed contribution rates to pay the normal cost of benefits, expenses, and amortize the unfunded actuarial accrued liability. In addition to the fixed contributions, members and employers may make additional contributions to purchase uncredited prior service. These purchase or acquisition payments are also included as contributions. As the SDRS membership ages, the number and amount of purchases have grown.

Income from investments is the other primary source of revenue for SDRS. The actuarial assumed investment rate is 7.75% at June 30, 2010. The investment returns were 18.70% for 2010 and (20.36)% for 2009.

Deductions from plan net assets are primarily benefit payments. During 2010, SDRS paid \$326 million to benefit recipients or 6.30% more than 2009. The increase is due to added recipients and the annual 3.10% cost-of-living adjustment. Refunds of accumulated contributions during 2010 increased 20.30%. Administrative costs of SDRS represent less than 0.05% of plan net assets.

A summary of the changes in plan net assets is shown below:

	<u>2010</u>	<u>2009</u>	<u>Percentage change</u>
Additions:			
Employee contributions	\$ 98,347,135	95,457,518	3.0%
Employer contributions	96,914,192	94,244,915	2.8
Investment income (loss)	1,011,107,887	(1,518,619,609)	166.6
	<u>1,206,369,214</u>	<u>(1,328,917,176)</u>	<u>190.8</u>
Deductions:			
Benefits	325,951,211	306,769,037	6.3
Refunds of contributions	29,148,085	24,225,249	20.3
Administrative expenses	3,402,075	3,428,853	(0.8)
Total deductions	<u>358,501,371</u>	<u>334,423,139</u>	<u>7.2</u>
Net increase (decrease) in plan net assets	847,867,843	(1,663,340,315)	151.0
Net assets held in trust for pension benefits:			
Beginning of year	<u>5,648,767,146</u>	<u>7,312,107,461</u>	<u>(22.7)</u>
End of year	<u>\$ 6,496,634,989</u>	<u>5,648,767,146</u>	<u>15.0%</u>

Investments

SDRS investment portfolio management is the statutory responsibility of the South Dakota Investment Council. The South Dakota Investment Office is the primary investment manager, but the Investment Council may utilize the services of external money managers.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

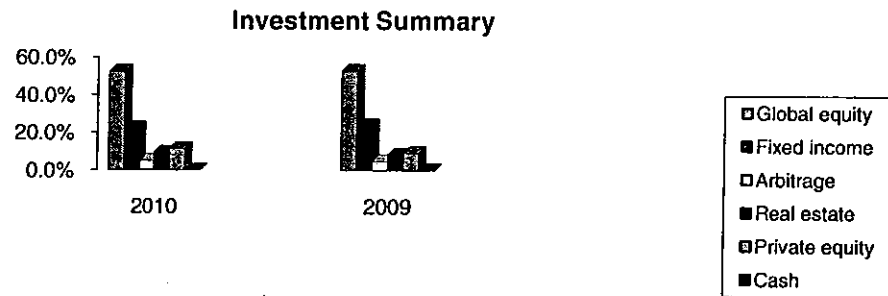
June 30, 2010

Investment performance during 2010 and 2009 was 18.70% and (20.36)%, respectively.

The Investment Council is governed by the prudent-man standard, as defined in South Dakota Codified Law 4-5-27:

4-5-27. Prudent-man standard required in investments. Any investments under the provisions of §4-5-12 to 4-5-39, inclusive, shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Though monthly benefit payments exceed monthly contributions, the SDRS is not subject to sudden, substantial, and unexpected withdrawals. As a result, it is not necessary to maintain a high percentage of assets in short-term investments unless that is deemed to be the best investment strategy. This allows the SDRS trust fund to be fully invested in a diversified portfolio of securities.



Plan Status

While the markets have not always made it possible to achieve the long-term assumptions, the System's funding remains solid. The reserve for long-term benefit goals has provided a process for both improving benefits and protecting the System in down markets.

Requests for Information

Requests for information about SDRS may be directed to the South Dakota Retirement System at P.O. Box 1098, Pierre, SD 57501. You may also contact SDRS online at www.state.sd.us/sdrs/.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Plan Net Assets

June 30, 2010

Assets:

Cash and cash equivalents	\$ 6,180,991
Receivables:	
Employer	2,005,112
Employee	3,174,997
Benefits	68,307
Unsettled investment sales	1,457,732
Accrued interest and dividends	<u>16,661,825</u>
Total receivables	<u>23,367,973</u>
Investments, at fair value:	
Fixed income	1,890,074,714
Equities	3,334,912,388
Real estate	604,352,493
Private equity	<u>734,022,466</u>
Total investments, at fair value	<u>6,563,362,061</u>
Other assets	<u>46,680</u>
Total assets	<u>6,592,957,705</u>

Liabilities:

Accounts payable and accrued expenses	2,649,600
Securities sold, but not yet purchased, at fair value	78,940,680
Unsettled investment purchases	13,804,034
Due to brokers – futures transactions	<u>928,402</u>
Total liabilities	<u>96,322,716</u>
Net assets held in trust for pension benefits (see schedule of funding progress)	<u>\$ 6,496,634,989</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year ended June 30, 2010

Additions:

Contributions:

Employee	\$ 98,347,135
Employer	<u>96,914,192</u>
Total contributions	<u>195,261,327</u>

Investment income:

From investing activities:

Net appreciation in fair value of investments	869,457,065
Interest	99,355,754
Dividends	77,784,893
Real estate	<u>4,148,245</u>

Investment income 1,050,745,957

Less investment activity expenses (39,638,070)

Net investment income 1,011,107,887

Total additions 1,206,369,214

Deductions:

Benefits	325,951,211
Refunds of contributions	29,148,085
Administrative expenses	<u>3,402,075</u>

Total deductions 358,501,371

Net increase in plan net assets 847,867,843

Net assets held in trust for pension benefits (see schedule of funding progress):

Beginning of year 5,648,767,146

End of year \$ 6,496,634,989

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(1) General Description of the System

The South Dakota Retirement System (SDRS) is a cost-sharing, multiple-employer public employee retirement system (PERS) established to provide retirement benefits for employees of the state of South Dakota (the State) and its political subdivisions. Members of SDRS include full-time employees of public schools, the State, the Board of Regents, city and county governments, and other public entities. Public schools, cities, and counties may choose not to include certain full-time employees in the system.

SDRS is considered a part of the State financial reporting entity and is included in the State's financial report as a pension trust fund. Authority for establishing, administering, and amending plan provisions is found in South Dakota Codified Law (SDCL) 3-12.

The South Dakota Retirement System Board of Trustees (the Board) is the governing authority of SDRS. The Board consists of 14 elected representatives from participating groups, two appointees of the governor, and an ex-office nonvoting representative of the South Dakota Investment Council. The elected representatives of the Board are two teacher members; two State employee members; a participating municipality member; a participating county member; a participating classified employee member; a current contributing Class B member other than a justice, judge, or magistrate judge; a county commissioner of a participating county; a school district board member and an elected municipal official of a participating municipality; a retiree; and a faculty or administrative member employed by the Board of Regents. The two Governor's appointees consist of one head of a principal department established pursuant to SDCL 1-32-2, or one head of a bureau under the office of executive management and one individual from the private or public sector.

SDRS is a hybrid defined benefit plan designed with several defined contribution plan type provisions. The system includes two classes of members: Class A-general members and Class B-public safety and judicial members. Members and their employers make matching contributions, which are defined in State statute. SDRS may expend up to 3% of the annual contributions for administrative expenses subject to approval by the executive and legislative branches of the State.

SDRS provides retirement, disability, and survivor benefits. The right to receive retirement benefits vests after three years of contributory service. Class A members and Class B judicial members who retire after age 65 with three years of service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A members where the sum of age and credited service is equal to or greater than 85 or after age 55 for Class B judicial members where the sum of age and credited service is equal to or greater than 80. Class B public safety members can retire with an unreduced annual retirement benefit after age 55 with three years of contributory service. An unreduced annual retirement benefit is also available after age 45 for Class B public safety members where the sum of age and credited service is equal to or greater than 75. All retirement benefits that do not meet the above criteria may be payable at a reduced level.

The annual increase in the amount of the SDRS benefits payable on each July 1st is indexed to CPI and based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more – 3.1% COLA

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Notes to Financial Statements

June 30, 2010

- If the SDRS market value funded ratio is 80.0% to 99.9%, index with the CPI
 - * 90.0% to 99.9% funded – 2.1% minimum and 2.8% maximum COLA
 - * 80.0% to 90.0% funded – 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% – 2.1% COLA

All benefits except those depending on the Member's Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

SDRS is a qualified defined benefit retirement plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. SDRS last received a favorable determination letter dated August 13, 1996, in which the Internal Revenue Service stated that the System, as then designated, was in compliance with the applicable requirements of the Internal Revenue Code. SDRS has been amended since receiving the determination letter and has requested a new determination letter. SDRS believes that the system currently is designed and being operated in compliance with the applicable requirements of the Internal Revenue Code, and therefore, SDRS continues to be tax-exempt as of June 30, 2010. Therefore, no provision for income taxes has been included in SDRS' financial statements.

SDRS is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. SDRS participates in the various programs administered by the State. These risk management programs are funded through assessments charged to participating entities. The risk management programs include (1) coverage for risks associated with automobile liability and general tort liability (including public officials' errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State's Public Entity Pool for Liability Fund, (2) coverage of employee medical claims through the State's health insurance program, (3) coverage for unemployment benefits through the State's Unemployment Insurance Fund, and (4) coverage for workers' compensation benefits through the State's Workers' Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

As of June 30, 2010, the number of participating governmental employers is as follows:

School districts	170
State of South Dakota	1
Board of Regents	1
Municipalities	147
Counties	64
Boards and commissions	87
Total employers	<u>470</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

At June 30, 2010, SDRS membership consists of the following:

Retirees and beneficiaries currently receiving benefits:	
Class A (general employees)	19,382
Class B (public safety and judicial employees)	<u>1,179</u>
Total retirees and beneficiaries	<u>20,561</u>
Terminated members entitled to benefits but not yet receiving them:	
Class A (general employees)	13,174
Class B (public safety and judicial employees)	<u>483</u>
Total terminated members	<u>13,657</u>
Current active members:	
Vested:	
Class A (general employees)	29,157
Class B (public safety and judicial employees)	2,067
Nonvested:	
Class A (general employees)	7,174
Class B (public safety and judicial employees)	<u>616</u>
Total current active members	<u>39,014</u>
Grand total	<u><u>73,232</u></u>

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting and Presentation

The accompanying financial statements are prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles applicable to governmental accounting for a pension trust fund. Employee and employer contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Pension benefit payments are due the first day of the month following the retirement of a member, and the first of each month thereafter. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and changes therein. Actual results could differ from

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

those estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.

(b) *Method Used to Value Investments*

Investments are reported at fair value. Equity securities include common stocks, preferred stocks, convertible debentures, arbitrage securities, and equity international funds. The fixed income securities include U.S. government and government-backed bonds and corporate bonds.

The fair value of investments in securities is determined based on closing market prices at June 30, 2010 for those securities traded on national and international stock exchanges and at the average of bid-and-asked quotations for those securities traded in the over-the-counter markets, as available. In general, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. The value of foreign securities in foreign currency amounts is expressed in U.S. dollars at the closing daily rate of exchange. Purchases and sales are recorded as of the trade date.

Alternative investments consist of investments in a variety of markets and industries through partnerships, corporate entities, co-investments, and other investment vehicles. For alternative investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, values these investments in good faith based upon the investment's current financial statements or other information provided by the underlying investment advisor. For all of these alternative investments, SDRS has determined that net asset value reported by the underlying fund approximates the fair value of the investment. These fair value estimates are, by their nature, subjective and based on judgment. These alternative investments were valued at \$2,090,112,054 (32% of net assets) at June 30, 2010. The estimated fair value of these investments may differ significantly from values that would have been used had a ready market existed.

Foreign exchange rate gains and losses are included with the net appreciation in fair value in investments. Futures contracts are marked to market based on quoted futures prices with changes in fair value reflected in the current period.

Interest and dividends are accrued in the period in which they are earned.

(3) Contributions and Reserves

(a) *Contributions*

Covered employees are required by statute to contribute a percentage of their salary to SDRS as follows:

Class A members	6.0% of salary
Class B judicial members	9.0% of salary
Class B public safety members	8.0% of salary

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Notes to Financial Statements

June 30, 2010

All participating employers are required to contribute an amount equal to the members' contributions. Members may make an additional contribution of 1.2% of compensation for optional spouse coverage.

SDRS is funded by fixed member and employer contributions at a rate established by law. On an annual basis, an independent actuarial valuation of SDRS is made to determine the adequacy of the fixed contractually required contributions to pay the normal cost, expenses, and amortize the frozen unfunded actuarial accrued liability (UAAL). The June 30, 2010 actuarial valuation of the plan determined that the contractually required employer contributions equal the requirements for the annual required contribution of the employers under Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*; and the contractually required employer contributions are sufficient to pay the employer normal cost, expenses, and amortize the frozen UAAL over a period of less than 30 years (30 years as of June 30, 2010). The maximum contributions limits are not considered in the projection of pension benefit liabilities. Annual required contributions of the employer equal to the contractually required contributions have been listed below pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

	<u>Employer</u>	<u>Percentage contributed</u>
Year ending June 30:		
2010	\$ 96,914,192	100%
2009	94,244,915	100
2008	89,766,090	100
2007	85,361,762	100

Contributions during fiscal year 2010 totaling \$195,261,327 (\$98,347,135 employee and \$96,914,192 employer) were made in accordance with statutory rates. These contributions represent 100% of current year covered payroll for all participating units. The employee contributions exceed the employer contributions because of optional spouse coverage contributions and employee service purchase payments.

SDRS allows participating entities to pay their deferred contributions for funding of accrued benefits over periods of up to 20 years and members to pay for the purchase of certain prior service over periods of up to 10 years. Interest is charged at rates of 5% to 8%.

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Notes to Financial Statements

June 30, 2010

Future payments will be received as follows:

	<u>Employees</u>
Year ending June 30:	
2011	\$ 451,892
2012	333,167
2013	273,655
2014	204,812
2015	13,886
Later	<u>29,477</u>
	1,306,889
Less amount representing interest	<u>—</u>
Deferred contributions receivable at June 30, 2010	<u>\$ 1,306,889</u>

(b) Reserves

The reserve for funding of long-term benefit goals is designed to fund benefit improvements and provide the plan with protection against adverse experience. The reserve for funding of long-term benefit goals is equal to the cumulative amounts credited or debited annually based on the immediate recognition of actuarial investment losses, the five-year recognition of actuarial investment gains, and the five-year recognition of SDRS liability gains or losses, less reductions described below. If benefit improvements are enacted into law and funded from the reserve for funding of long-term benefit goals, the reserve for funding of long-term benefit goals is reduced by the present value of all benefits for those improvements. The reserve for funding of long-term benefit goals may also be reduced to offset unfavorable experience, if required, to meet the funding objectives of SDRS as established by the Board of Trustees. As of June 30, 2010, the balance in the reserve for funding of long-term benefit goals is \$(1.3) billion.

(4) Funded Status and Funding Progress – Pension Plan

As of June 30, 2010, the most recent actuarial valuation date, the plan was 96.3% funded. The actuarial accrued liability for benefits was \$7.4 billion, and the actuarial value of assets was \$7.1 billion, resulting in an UAAL of \$273.4 million. The covered payroll (annual payroll of active employees covered by the plan) was \$1.49 billion, and the ratio of the UAAL to the covered payroll was 18.3%.

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to financial statements on page 26, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

In the June 30, 2010 actuarial valuation, the entry age frozen UAAL method was used. The actuarial assumptions included (a) 7.75% investment rate of return and (b) projected salary increases ranging from 4.15% to 8.13%. Both (a) and (b) include the inflation component of 2.8%. The actuarial value of assets was determined by the following method: assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year, and constrained to a range of 80% to 120% of market.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2010 was 30 years.

(5) Cash and Investments

Cash and cash equivalents are held by the State Treasurer and were invested in the State's pooled investment fund. Investments in the State's pooled investment fund consist primarily of commercial paper rated A1 or P2 or better, short-term U.S. Treasury obligations, bank certificates of deposit, and money market funds.

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. The South Dakota Investment Council is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current South Dakota Investment Council investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). Below is a detail of the investment balances and amounts managed by the respective fund managers:

	<u>Cost</u>	<u>Fair value</u>
State of South Dakota Investment Council	\$ 4,609,008,319	4,472,828,292
Sanders Capital	25,175,661	21,572,765
Sanders All Asset Value	14,999,265	12,984,693
Blackstone Real Estate Partners	618,187,359	470,964,184
Cargill North American Real Estate Partners	162,594,758	96,256,368
CINVIN Fund 4	61,685,555	60,347,511
Pinebridge	13,886,615	14,065,416
CVI Global Value Fund	170,160,571	155,554,605
CVI Specialized Ventures Fund	17,846,694	8,115,641
PIMCO Distressed Mtg Fund II	114,535,836	140,510,723
TCW Specialized Mtg Credits	149,362,713	161,915,321
Oaktree Loan Fund 2x	35,046,235	32,934,514
Blackstone Distressed Securities	385,144	5,002,920
Blackstone Credit Liquidity	25,880,855	28,136,145
Silver Lake Partners LP	105,533,845	119,510,114
KKR Associates	62,451,392	59,454,028
Cypress Merchant Banking Partners LP	20,905,207	8,833,309
Capital International	34,627,160	43,974,649
Apollo	38,416,684	24,860,072
Bridgewater Pure Alpha Fund II	50,000,000	67,438,315
Dimensional Fund Advisors, Inc.	8,918,381	36,942,851

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

	<u>Cost</u>	<u>Fair value</u>
Blackstone Private Equity	\$ 218,262,574	200,404,510
Doughty Hanson & Co. Private Equity IV	66,756,498	71,686,785
Brandes Global Mid-Cap	37,881,714	32,020,215
Doughty Hanson	32,847,303	12,271,869
CVC	43,883,065	52,571,780
Carlyle IV	34,182,119	42,628,880
Riverstone	15,016,634	18,282,746
GE Asset Management	40,920,000	49,030,105
Elevation Partners	32,614,456	28,635,651
Crossroads	13,667,216	11,554,506
DLJ Merchant Banking Partners LP	3,822,221	2,072,578
Total investments	6,879,462,049	6,563,362,061
Securities sold, but not yet purchased	<u>(75,880,202)</u>	<u>(78,940,680)</u>
Total	<u>\$ 6,803,581,847</u>	<u>6,484,421,381</u>

(a) Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are held in the possession of an outside party. SDRS has no formal deposit policy specific to custodial credit risk. At June 30, 2010, SDRS has bank balances in various foreign currencies. These deposits are not collateralized or covered by depository insurance. As a result, \$6,386,440 was exposed to custodial credit risk.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. SDRS has no formal policy for investment custodial credit risk. No collateral securities were held at June 30, 2010.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(b) *Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The SDRS's investment grade fixed income portfolio's duration must fall between 70% and 130% of the duration of the Citigroup Broad Investment Grade (BIG) Index. Modified duration estimates the sensitivity of a bond's price to interest rate changes. The durations of the various investment types are listed in the following table:

	<u>Fair value</u>	<u>Duration (in years)</u>
Investment type:		
U.S. Treasuries	\$ 95,143,461	8.23
U.S. Treasury strips	36,600,000	12.88
U.S. Treasury Bills	12,097,115	0.22
U.S. agencies	22,822,295	4.84
Investment grade corporates	355,360,921	3.78
High-yield corporates	152,259,393	3.63
Mortgage-backed securities	296,635,570	2.15
Mutual funds	190,024,832	—
FDIC Temporary Liquidity Guarantee Program	22,488,467	2.30
Total	<u>\$ 1,183,432,054</u>	3.33

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(c) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SDRS. The South Dakota Investment Council sets the investment policy annually for the SDRS. This policy establishes the average percentage invested in each asset category and the fund allocation range that each asset category can vary during the fiscal year. As of June 30, 2010, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service.

	<u>Fair value</u>
Moody's rating:	
Aaa	\$ 452,655,382
Aa	52,323,650
A	116,179,666
Baa	138,325,610
Ba	94,005,225
B	10,988,413
Caa	1,830,705
Ca	—
C	—
Not rated	93,967,046
Total	<u>\$ 960,275,697</u>

(d) Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of SDRS' investment in a single issuer. SDRS does not have guidelines to limit its investments in any particular investment. SDRS does not have investments in any one issuer that represent 5% or more of the total fair value of investments as of June 30, 2010 (excluding those issued by or explicitly guaranteed by the U.S. government).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SDRS's exposure to foreign currency risk derives from its positions in foreign currency and foreign-currency-denominated equity and fixed income investments. SDRS does not hedge foreign currency back to U.S. dollars (to match the unhedged benchmark), but does allow hedging under certain circumstances, when deemed appropriate. The portfolio's exposure to foreign currency risk at June 30, 2010 is as follows (in U.S. dollar fair value):

	Equities U.S. dollar fair value	Fixed income U.S. dollar fair value	Cash U.S. dollar fair value	Total
Currency:				
Australian Dollar	\$ 4,861,929	—	—	4,861,929
Brazilian Real	1,478,522	—	13,820	1,492,342
British Pound	161,999,425	—	179,530	162,178,955
Canadian Dollar	51,074,020	—	1,578,454	52,652,474
Danish Kroner	1,405,441	—	626	1,406,067
Euro	238,272,963	—	3,650,127	241,923,090
Hong Kong Dollar	3,439,703	—	—	3,439,703
Hungarian Forint	192,667	—	—	192,667
Israeli Shekel	814,594	—	—	814,594
Japanese Yen	151,779,520	—	963,099	152,742,619
Korean Won	9,668,058	—	—	9,668,058
New Zealand Dollar	779,841	—	—	779,841
Norwegian Krone	4,165,993	—	15	4,166,008
Singapore Dollar	102,696	—	—	102,696
South African Rand	16,885	—	764	17,649
Swedish Krona	1,671,482	—	5	1,671,487
Swiss Franc	113,222,225	—	—	113,222,225
Turkish Lira	955,030	—	—	955,030
Total fair value	\$ 745,900,994	—	6,386,440	752,287,434

Investments with limited partnerships and certain global equity investments with outside managers, which are not included in the table above, may expose SDRS's portfolio to additional foreign currency risk. The total fair value of investments in real estate and private equity limited partnerships as of June 30, 2010 was \$1,338,374,957. The total fair value of global equity, arbitrage equity, and distressed and high-yield fixed income investments managed by outside managers was \$102,623,084, \$104,381,166, and \$532,169,869, respectively.

(f) Return on Investments

During fiscal year 2010, SDRS's investments (including investments bought and sold, as well as held during the year) appreciated in value by \$869,457,065.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior years and current year.

Change in Fair Value of Investments

Appreciation in fair value of investments:	
Equities	\$ 287,234,207
Fixed income	154,735,975
Real estate	90,062,280
Private equity	195,853,634
Total increase in fair value	<u>727,886,096</u>
Realized gain (loss) on investments sold:	
Equities	136,965,388
Fixed income	25,575,299
Real estate	(17,718,783)
Private equity	(14,178,474)
Total net realized losses	<u>130,643,430</u>
Net gain on futures contracts	<u>10,927,539</u>
Net appreciation in fair value of investments	<u>\$ 869,457,065</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(6) Derivatives

Derivatives are generally defined as contracts whose values depend on, or derive from, the value of an underlying asset, reference rate, or index. SDRS is exposed to various derivative products through the investment management of the SDIC and its outside managers. All of the SDRS's derivatives are classified as investment derivatives.

Futures Contracts

A futures contract is a contract to buy or sell units of an index or financial instrument at a specified future date at a price agreed upon when the contract is originated. The South Dakota Investment Council purchases and sells futures contracts as a means of adjusting the SDRS portfolio mix at a lower transaction cost than the transactions, which would otherwise occur in the underlying portfolios. During fiscal year ended June 30, 2010, S&P 500 futures and 10-year U.S. Treasury note futures were utilized. Upon entering into such a contract, the SDRS pledges to the broker cash or U.S. government securities equal to the minimum initial margin requirement of the futures exchange. Additionally, SDRS receives or pays a daily variation margin, which is an amount of cash equal to the daily fluctuation in value of the contract. The pending variation margin at June 30, 2010 of \$(928,402) is presented in the statement of net assets as "Due to brokers - futures transactions." The change in fair value of the futures contracts is presented in the statement of changes in net assets as "Net appreciation in fair value of investments." The net change in fair value from futures contracts for fiscal year ended June 30, 2010 was \$10,927,539. Futures contract positions at June 30, 2010 were as follows:

Description	Expiration date	Open position	Number of contracts	Contract size	Fair value
U.S. Treasury note	September 2010	Long	180	100,000 par value 6% U.S. Treasury note	\$ 332,110
S&P 500 index	September 2010	Long	386	250 index	(2,799,025)

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

Foreign Currency Forward Contracts

The SDIC enters into foreign exchange forward contracts for SDRS to manage foreign currency exposure, as permitted by portfolio policies. The fair values of the contracts are presented in the statement of net assets as investments – equities. The change in fair value of the forward contracts is presented in the statement of changes in net assets as “Net appreciation in fair value of investments.” The net change in fair value from foreign currency forward contracts for fiscal year ended June 30, 2010 was \$8,492,143. At June 30, 2010, the foreign currency forward contracts outstanding were as follows:

Description	Notional amount	Maturity date	Fair value (US dollars)
Forward sale	(660,384) AUD	7/30/2010	\$ (8,345)
Forward sale	(14,000,000) EURO	7/22/2010	1,708,160
Forward sale	2,868,600 EURO	9/02/2010	37,379
Forward sale	(64,554,750) GBP	9/22/2010	858,756
Forward sale	(198,851) GBP	7/22/2010	2,395
Forward sale	(1,540,195) GBP	8/16/2010	49,173
Forward sale	(971,852) GBP	9/02/2010	(37,484)
Forward sale	(707,726) GBP	5/16/2011	3,424
Forward purchase	200,900,000 CNY	7/26/2011	2,062,048
Forward purchase	159,225,000 CNY	8/25/2011	1,827,516
Forward purchase	129,400,000 CNY	7/24/2014	(635,698)
Forward purchase	128,050,000 CNY	7/28/2014	(837,722)
Forward purchase	150,250,000 CNY	3/30/2015	(2,515,562)
Forward purchase	1,500,000 EURO	7/22/2010	(44,826)
Forward purchase	3,799,562,200 JPY	7/15/2010	2,030,363

(a) Credit Risk

SDRS is exposed to credit risk on derivative instruments that are in asset positions. The SDIC attempts to minimize credit risk by entering into derivatives contracts with major financial institutions. At June 30, 2010, the net fair value of foreign currency forward contracts was \$4,499,577. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. The credit ratings of the counterparties are as follows:

	Number of counterparties	Fair value
Moody's credit rating:		
A1	1	\$ 4,598,995
Aa2	1	(99,418)

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(b) Interest Rate Risk

SDRS is exposed to interest rate risk on its 10-year U.S. Treasury note futures contract. As interest rates increase, the value of the futures contract decreases. The fair value of futures contracts with notionals priced to the 10-year U.S. Treasury note were \$332,110.

(c) Foreign Currency Risk

SDRS is exposed to foreign currency risk on its foreign currency forward contracts because they are denominated in foreign currencies. The net fair value of the foreign currency forward contracts in U.S. dollars is \$4,499,577.

(7) Compensated Absences

Annual leave is earned by all SDRS employees. Upon termination, SDRS employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2010, a liability existed for accumulated annual leave calculated at the employees' June 30, 2010 pay rate in the amount of \$114,776. Employees who have been continuously employed by SDRS and the State for at least seven years prior to the date of their retirement, voluntary resignation, or death will receive payment for one-fourth of their accumulated sick leave balance with such payment not to exceed the sum of 12 weeks of the employee's annual compensation. For employees who have not been employed for seven continuous years, an accrued liability is calculated assuming the likelihood that they will meet the seven-year threshold in the future. At June 30, 2010, a liability existed for accumulated and accrued sick leave calculated at the employees' June 30, 2010 pay rate in the amount of \$134,921.

	<u>2010</u>	<u>2009</u>	<u>Percentage change</u>
Total compensated absences	\$ 249,697	244,814	2.00%

The total leave liability for the current year is on the statement of net assets available for benefits in accounts payable and accrued expenses.

(8) Operating Leases

The SDRS has entered into an agreement to lease office space. The lease was effective September 2007 and has a term of five years. A schedule of minimum office rental payments as of June 30, 2010 is as follows for the fiscal year ending June 30:

2011	\$ 105,389
2012	<u>105,389</u>
Total remaining minimum payments	<u>\$ 210,778</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(9) Supplemental Retirement Plan

SDRS offers a deferred compensation plan known as the Supplemental Retirement Plan (SRP), created in accordance with Internal Revenue Code Section 457. SRP is available to all public employees and permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseen emergency.

All amounts of compensation deferred under the SRP, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are at all times held in trust for the exclusive benefit of the participants until made available to a participant or the participant's beneficiary.

Of the \$132,425,979 net assets available for plan benefits at June 30, 2010, \$83,073,567 was held in trust for employees of the State, while the remaining \$49,352,412 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$507,589 is included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2010.

(10) Special Pay Plan

The Special Pay Plan (SPP) was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the SDRS Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the plan. The SPP mandates that qualifying employees (over age 55 and \$2,000 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

Of the \$19,448,990 net assets available for plan benefits at June 30, 2010, \$11,014,372 was held in trust for employees of the State, while the remaining \$8,434,618 represents the assets held in trust for employees of other jurisdictions.

(11) Plan Termination

SDRS is administered in accordance with South Dakota statutes. The statutes provide for full vesting in accrued benefits upon termination of the plan (SDCL 3-12-72.2).

(12) Commitments

At June 30, 2010, SDRS had uncalled capital commitments to private equity limited partnerships totaling approximately \$428,047,852 and to real estate limited partnerships totaling approximately \$456,628,093. The commitments may be called at the discretion of the general partner or may never be called. As capital is called, it is funded from capital and earnings returned by the limited partnerships or from other assets.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2010

(13) Litigation

Four SDRS retirees initiated a class action challenging the constitutionality of a portion of Senate Bill (SB) 20 from the 2010 state Legislative Session, which reduced the annual cost of living increases to retirement benefit participants for state fiscal year 2011 and may negatively impact increases in future years. *Merton B. Tice Jr. et. al. v. State of South Dakota et. al.* Civ. No. 10-225 was filed in the Sixth Judicial Circuit Hughes County in June of this year. Plaintiffs are seeking injunctive relief, damages, and attorney fees for themselves and a pled class. If successful, Plaintiffs' lawsuit could have a significant negative actuarial impact on the South Dakota Retirement System Member Trust Fund. SDRS contends it has strong defenses to class certification and to the merits of the Plaintiffs' claims, and its counsel are vigorously defending the action. The pending legal action does not represent a significant immediate negative contingency. At this stage of the litigation, it is not possible for SDRS to assess the potential effect, if any, to SDRS Member Trust Fund.

SOUTH DAKOTA RETIREMENT SYSTEM

Required Supplementary Information

June 30, 2010

Schedule of Funding Progress						
(Dollar amounts in millions)						
Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability – entry age (AAL)	Unfunded actuarial accrued liability (UAAL) (b-a)	Funded ratio (a/b)	(c) Covered payroll	UAAL as a percentage of covered payroll ((b-a)/c)
6/30/2005	\$ 5,381.0	5,571.8	190.8	96.6%	\$ 1,206.1	15.8%
6/30/2006	5,668.5	5,859.9	191.4	96.7	1,229.9	15.6
6/30/2007	6,526.5	6,718.8	192.3	97.1	1,297.3	14.8
6/30/2008	6,784.3	6,976.8	192.5	97.2	1,363.9	14.1
6/30/2009	6,778.5	7,387.4	608.9	91.8	1,450.7	42.0
6/30/2010	7,119.9	7,393.3	273.4	96.3	1,491.1	18.3

Schedule of Employer Contributions			
Last Six Years			
Year ended June 30:	Annual required contributions	Percentage contributed	
2005	\$ 77,474,967	100%	
2006	80,829,338	100	
2007	85,361,762	100	
2008	89,766,090	100	
2009	94,244,915	100	
2010	96,914,192	100	

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2010	Actuarial assumptions:	
Actuarial cost method	Entry age with frozen unfunded actuarial accrued liability	Investment rate of return *	7.75%
		Projected salary increase *	4.15% to 8.13%
Amortization method	Level percentage-open	based on age, with average of 5.5%	
Remaining amortization period	30 years	Cost of living adjustments	2.80%
Asset valuation method	Assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year, and constrained to a range of 80% to 120% of market	* Includes inflation at 4%	

See accompanying independent auditors' report.

SOUTH DAKOTA RETIREMENT SYSTEM

Supplementary Information

June 30, 2010

Schedule of Administrative Expenses	
Year ended June 30, 2010	
Personal services:	
Salary and per diem	\$ 1,431,901
Employee benefits	376,734
Total personal services	<u>1,808,635</u>
Operating expenses:	
Travel	62,436
Contractual services:	
Finance	103,376
Valuations	103,770
Consulting	131,335
Studies	10,806
Special studies	11,587
Legal	5,886
Communications	22,700
Medical	53,475
Operations	766,611
Total contractual services	<u>1,209,546</u>
Supplies and materials	277,020
Capital assets	44,438
Total operating expenses	<u>1,593,440</u>
Total administrative expenses	<u><u>\$ 3,402,075</u></u>

See accompanying independent auditors' report

SOUTH DAKOTA RETIREMENT SYSTEM

Supplementary Information

June 30, 2010

Schedule of Investment Activity Expenses

Year ended June 30, 2010

Investment managers:

State of South Dakota Investment Council	\$ 4,314,852
Pinebridge	122,410
Apollo Real Estate Advisors LP	482,754
Blackstone Distressed Debt	258,967
Blackstone Private Equity	(319,873)
Blackstone Real Estate Partners	12,492,118
Brandes Investment Partners	326,342
Capital International	1,222,497
Cargill North American Real Estate Partners	2,018,564
Carlyle	1,012,082
CINVIN	1,772,921
CVC	820,302
CVI	2,880,542
Cypress Merchant Banking Partners LP	126,283
Dimensional Fund Advisors, Inc.	153,993
DLJ Merchant Bankers	59,247
Doughty Hanson & Co. European Real Estate	1,575,357
Doughty Hanson & Co. Private Equity IV	1,967,574
Elevation Partners	763,938
GE Asset Management China	940,731
KKR Associates	264,008
Lehman Crossroads Investment Advisors LP	475,736
Oaktree Loan Fund 2x	278,025
PIMCO Distressed Mtg Fund II	1,775,631
Research Affiliates	86,624
Sanders All Asset Value	55,586
Sanders Capitol	44,039
Riverstone	554,886
Silver Lake Partners LP	1,430,076
TCW Specialized Mtg Credits	1,681,858
Total investment activity expenses	\$ 39,638,070

See accompanying independent auditors' report.

SOUTH DAKOTA RETIREMENT SYSTEM

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

June 30, 2010



KPMG LLP
Suite 1501
222 South 15th Street
Omaha, NE 68102-1610

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System:

We have audited the financial statements of South Dakota Retirement System (SDRS) as of and for the year ended June 30, 2010, and have issued our report thereon dated November 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered SDRS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SDRS's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDRS's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and management, and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 22, 2010

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1501
222 South 15th Street
Omaha, NE 68102-1610

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System
Supplemental Retirement Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of June 30, 2010, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Supplemental Retirement Plan as of June 30, 2010, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2010, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 33 through 35 is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Omaha, Nebraska
November 22, 2010

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2010

This section presents management's discussion and analysis of the South Dakota Retirement System Supplemental Retirement Plan's (SRP or the Plan) financial position and performance for the year ended June 30, 2010. This section is intended to supplement the SRP financial statements.

Financial Highlights

- The net assets available for plan benefits of the SRP increased by \$20.6 million during fiscal year 2010. This increase was primarily attributable to investment gains during the year and contributions outweighing distributions to participants.
- The SRP paid \$4.3 million to benefit recipients in fiscal year 2010 compared to \$4.8 million in 2009. The SRP received \$13.1 million in contributions in fiscal year 2010 compared to \$12.1 million in 2009.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of plan net assets as of June 30, 2010, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SRP was established in accordance with Internal Revenue Code Section 457 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SRP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2010

A summary of the net assets held in trust for plan benefits is shown below:

Summary of Plan Net Assets

June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets:		
Investments, at fair value	\$ 131,779,964	111,275,660
Cash	112,666	151,627
Accrued interest	9,189	9,676
Contributions receivable	553,994	398,031
Total assets	\$ 132,455,813	111,834,994
Liabilities:		
Accounts payable	\$ 29,834	25,515
Net assets held in trust for plan benefits	\$ 132,425,979	111,809,479

Change in Plan Net Assets

Additions to the net assets include contributions and net investment income (loss). Deductions from net assets are primarily benefit payments. During 2010, SRP paid \$4.3 million to benefit recipients, or 11% less than 2009.

A summary of the changes in plan net assets is shown below:

	<u>2010</u>	<u>2009</u>	<u>Percentage change</u>
Additions:			
Contributions – employee	\$ 13,091,834	12,142,599	7.82%
Investment income (loss)	12,198,062	(19,247,318)	163.38
	<u>25,289,896</u>	<u>(7,104,719)</u>	<u>455.96</u>
Deductions:			
Distributions to participants	4,331,269	4,847,929	(10.66)
Administrative expenses	342,127	276,679	23.66
Total deductions	<u>4,673,396</u>	<u>5,124,608</u>	<u>(8.80)</u>
Net increase (decrease) in plan net assets	20,616,500	(12,229,327)	268.58
Net assets held in trust for pension benefits:			
Beginning of year	111,809,479	124,038,806	(9.86)
End of year	<u>\$ 132,425,979</u>	<u>111,809,479</u>	<u>18.44%</u>

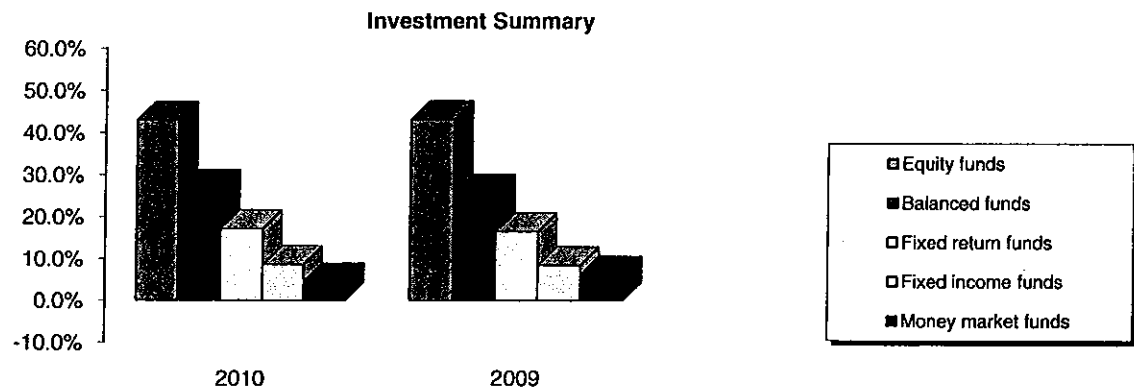
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2010

Investments

The selection of SRP investment portfolio alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SRP fund types.



Requests for Information

Requests for information about the SRP may be directed to the Supplemental Retirement Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SRP at (605) 224-2230, 1-800-959-4457, or online at www.srp457.com. You may link to the SRP Web site from the SDRS Web site at www.state.sd.us/sdrs/.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Statement of Plan Net Assets

June 30, 2010

Assets:

Investments, at fair value:

Equity funds	\$ 56,883,225
Balanced funds	35,462,845
Fixed return funds	22,743,006
Fixed income funds	11,372,726
Money market funds	5,318,162

Total investments, at fair value	131,779,964
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Cash	112,666
Accrued interest	9,189
Contributions receivable	553,994

Total assets	132,455,813
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Liabilities:

Accounts payable	29,834
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Net assets held in trust for plan benefits	\$ 132,425,979
--	----------------

Statement of Changes in Plan Net Assets

Year ended June 30, 2010

Additions:

Contributions -- employee	\$ 13,091,834
Investment income	12,198,062
Total additions	25,289,896

Deductions:

Distributions to participants	4,331,269
Administrative expenses	342,127
Total deductions	4,673,396

Net increase in plan net assets	20,616,500
---------------------------------	------------

Net assets held in trust for plan benefits:

Beginning of year	111,809,479
End of year	\$ 132,425,979

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2010

(1) Plan Description

The following description of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) General

The Plan was established in July 1987 in accordance with Internal Revenue Code Section 457 under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The state of South Dakota is a participating unit and every political subdivision thereof may become a participating unit in the Plan. The Plan permits employees of participating units to defer a portion of their salary until future years. The deferred compensation is not available to the participants until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary, shall be held in trust for the exclusive benefit of the participant.

(b) Contributions

Participants of the Plan may contribute an amount of not less than \$25 per month and not in excess of \$16,500 for calendar year 2010 or 100% of includable compensation. A participant may make a one-time election to defer an additional amount of twice the otherwise applicable limit during any of the three calendar years immediately preceding a participant's elected normal retirement age. If age 50 or over, participants may also defer additional contributions of \$5,500.

(c) Participant's Account

Each participant's account is credited with the participant's contributions, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) Distribution to Participants

Distributions of benefits to participants can be made upon termination, retirement, death, or unforeseeable emergency. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or installments, as defined in the plan agreement.

(e) Vesting

Participants are vested immediately in their contributions plus actual earnings thereon.

(f) Risks and Uncertainties

The Plan invests in various investment securities. These securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2010

securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of Plan net assets.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) Investments

Investments are carried at fair value based upon quoted market prices at June 30, 2010, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of United States and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2010

Changes in plan net assets for the year ended June 30, 2010 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income	Deductions	Transfers to/from related plan	Internal transfers	Ending balance	Market value as a percentage of plan assets
Money market:								
Vanguard Prime Reserve	\$ 6,949,611	717,016	6,650	(281,525)	---	(2,073,590)	5,318,162	4.0%
Balanced:								
Vanguard Target Ret Inc Fund	1,439,925	80,566	160,320	(92,718)	---	457,491	2,045,584	1.6
Vanguard Target Ret 2005	2,520,245	87,085	303,345	(145,255)	---	210,052	2,975,472	2.3
Vanguard Target Ret 2010	5,150,713	350,121	682,320	(438,750)	---	(46,245)	5,698,159	4.3
Vanguard Target Ret 2015	7,167,967	936,855	959,356	(487,548)	---	(25,492)	8,551,138	6.4
Vanguard Target Ret 2020	5,706,271	904,321	769,286	(125,713)	---	(70,734)	7,183,431	5.4
Vanguard Target Ret 2025	2,854,690	563,477	384,237	(30,601)	---	18,077	3,789,880	2.8
Vanguard Target Ret 2030	2,130,545	535,338	280,479	(29,026)	---	35,547	2,952,883	2.1
Vanguard Target Ret 2035	578,828	264,765	69,055	(15,485)	---	17,682	914,845	0.7
Vanguard Target Ret 2040	297,467	268,007	32,578	(4,599)	---	19,149	612,602	0.5
Vanguard Target Ret 2045	207,873	162,432	19,062	(734)	---	(2,965)	385,668	0.3
Vanguard Target Ret 2050	172,967	125,994	16,700	(489)	---	38,011	353,183	0.3
	<u>28,227,491</u>	<u>4,278,961</u>	<u>3,676,738</u>	<u>(1,370,918)</u>	<u>---</u>	<u>650,573</u>	<u>35,462,845</u>	<u>26.7</u>
Fixed return:								
Prudential	18,411,084	1,916,371	718,067	(1,385,433)	---	3,082,917	22,743,006	17.2
Fixed income:								
Vanguard Bond Market	9,377,341	1,196,493	932,066	(322,871)	---	189,697	11,372,726	8.6
Equity:								
Mutual shares	8,840,917	659,330	1,439,403	(273,567)	---	(401,392)	10,264,691	7.8
Windsor II Adm	12,245,193	940,833	1,596,296	(273,225)	---	(345,520)	14,163,577	10.7
Vanguard Inst Index	12,199,998	943,666	1,794,077	(350,684)	---	(805,298)	13,781,759	10.4
Vanguard Tot Int'l	5,413,916	564,908	443,567	(130,516)	---	(189,310)	6,102,565	4.6
Alliance Bern with App St	215,266	35,633	25,250	(3,732)	---	(6,758)	265,659	0.2
Dodge&Cox Int Stock Fund	821,525	178,201	88,732	(25,434)	---	43,449	1,106,473	0.8
Legg Mason Opp Fund	339,147	102,355	80,832	(6,581)	---	93,905	609,658	0.5
Legg Mason Value Trust	316,526	87,712	29,392	(6,757)	---	(47,319)	379,554	0.3
Growth fund of America	2,096,791	465,517	210,840	(47,126)	---	(4,817)	2,721,205	2.1
Capital World Grth & Inc	1,187,595	301,086	78,323	(45,956)	---	106,483	1,627,531	1.2
Vanguard Ext Mkt Idx Fund	4,132,037	458,612	962,509	(137,262)	---	(268,934)	5,146,962	3.9
Vanguard Strategic Equity	501,222	137,814	106,131	(7,490)	---	(24,086)	713,591	0.5
	<u>48,310,133</u>	<u>4,875,667</u>	<u>6,855,352</u>	<u>(1,308,330)</u>	<u>---</u>	<u>(1,849,597)</u>	<u>56,883,225</u>	<u>43.0</u>
Total								
investments	111,275,660	12,984,508	12,188,873	(4,669,077)	---	---	131,779,964	99.5
Other plan net assets	<u>533,819</u>	<u>107,326</u>	<u>9,189</u>	<u>(4,319)</u>	<u>---</u>	<u>---</u>	<u>646,015</u>	<u>0.5</u>
Total plan net assets	<u>\$ 111,809,479</u>	<u>13,091,834</u>	<u>12,198,062</u>	<u>(4,673,396)</u>	<u>---</u>	<u>---</u>	<u>132,425,979</u>	<u>100.0%</u>

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2010

(5) Federal Income Tax Status

The Plan is an eligible nonqualified deferred compensation plan under Section 457(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated September 15, 1988. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

(6) Transfers to Related Plan

During the year, no assets were transferred from the Plan into the South Dakota Retirement System Special Pay Plan (SPP), a related plan. Transfers between SRP and SPP are allowed under state statutes.

(7) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

June 30, 2010



KPMG LLP
Suite 1501
222 South 15th Street
Omaha, NE 68102-1610

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System
Supplemental Retirement Plan:

We have audited the financial statements of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of and for the year ended June 30, 2010, and have issued our report thereon dated November 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and management, and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 22, 2010

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1501
222 South 15th Street
Omaha, NE 68102-1610

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System
Special Pay Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Special Pay Plan (the Plan) as of June 30, 2010, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Special Pay Plan as of June 30, 2010, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 22, 2010 on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 45 through 47 is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Omaha, Nebraska
November 22, 2010

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2010

This section presents management's discussion and analysis of the South Dakota Retirement System Special Pay Plan's (SPP or the Plan) financial position and performance for the year ended June 30, 2010. This section is intended to supplement the SPP financial statements and notes.

Financial Highlights

- The net assets available for plan benefits of the SPP increased by \$3.4 million during fiscal year 2010. This increase was primarily attributable to additional participant contributions and investment gains.
- The SPP paid \$3.7 million to benefit recipients in fiscal year 2010 compared to \$3.2 million in 2009. The SPP received \$6.3 million in contributions in fiscal year 2010 compared to \$5.8 million in 2009.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of plan net assets as of June 30, 2010, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SPP was established in accordance with Internal Revenue Code Section 401 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SPP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2010

A summary of the net assets held in trust for plan benefits is shown below:

Summary of Plan Net Assets

June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets:		
Investments, at fair value	\$ 19,016,760	15,688,304
Cash	69,998	66,516
Accrued interest	—	692
Contributions receivable	369,437	344,597
Total assets	<u>19,456,195</u>	<u>16,100,109</u>
Liabilities:		
Accounts payable	7,205	4,095
Net assets held in trust for plan benefits	<u>\$ 19,448,990</u>	<u>16,096,014</u>

Changes in Plan Net Assets

Additions to the net assets mainly were due to contributions during the year. Deductions from net assets are primarily benefit payments and administrative expenses. During 2010, SPP paid \$3.7 million to benefit recipients, or 16.3% more than 2009.

A summary of the changes in plan net assets is shown below:

	<u>2010</u>	<u>2009</u>	<u>Percentage change</u>
Additions:			
Contributions – employee	\$ 6,286,808	5,811,813	8.17%
Investment income (loss)	800,839	(180,147)	544.55
Other income	24,975	24,120	3.54
	<u>7,112,622</u>	<u>5,655,786</u>	<u>25.76</u>
Deductions:			
Distributions to participants	3,734,671	3,210,440	16.33
Administrative expenses	24,975	24,120	3.54
Total deductions	<u>3,759,646</u>	<u>3,234,560</u>	<u>16.23</u>
Net increase in plan net assets	<u>3,352,976</u>	<u>2,421,226</u>	<u>38.48</u>
Net assets held in trust for pension benefits:			
Beginning of year	16,096,014	13,674,788	17.71
End of year	<u>\$ 19,448,990</u>	<u>16,096,014</u>	<u>20.83%</u>

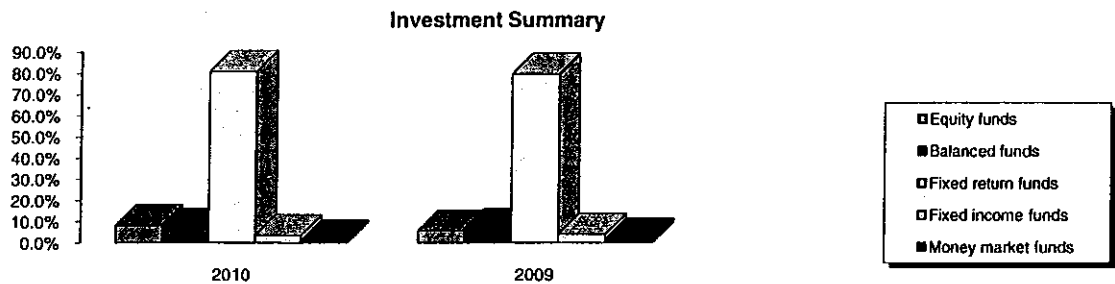
**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2010

Investments

The selection of SPP investment portfolios alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SPP fund types.



Requests for Information

Requests for information about the SPP may be directed to the Special Pay Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SPP at (605) 224-2230 or 1-800-959-4457.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Statement of Plan Net Assets

June 30, 2010

Assets:

Investments, at fair value:

Equity funds	\$ 1,567,322
Balanced funds	1,229,541
Fixed return funds	15,734,444
Fixed income funds	254,210
Money market funds	231,243

Total investments, at fair value	19,016,760
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Cash	69,998
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Contributions receivable	369,437
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Total assets	19,456,195
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Liabilities:

Accounts payable	7,205
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Net assets held in trust for plan benefits	\$ 19,448,990
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Statement of Changes in Plan Net Assets

Year ended June 30, 2010

Additions:

Contributions – employee	\$ 6,286,808
Investment income	800,839
Other income	24,975

Total additions	7,112,622
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Deductions:

Distributions to participants	3,734,671
Administrative expenses	24,975

Total deductions	3,759,646
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Net increase in plan net assets	3,352,976
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Net assets held in trust for plan benefits:

Beginning of year	16,096,014
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End of year	\$ 19,448,990
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See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2010

(1) Plan Description

The following description of the South Dakota Retirement System Special Pay Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) General

The Plan was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the South Dakota Retirement System Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the Plan. The Plan mandates that qualifying employees (over age 55 and \$2,000 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. Special pay is compensation other than regular salary or wages granted to a member of the South Dakota Retirement System and transferred in a sum to the Plan at termination of the member's employment. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

All amounts of special termination pay deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary for estate, shall be held in trust for the exclusive benefit of the participant.

(b) Contributions

Participants in the Plan can contribute the lesser of 100% of their one-time, lump-sum special pay associated with their termination or \$49,000 for calendar year 2010.

(c) Participant's Account

Each participant's account is credited with the participant's contribution, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) Distribution to Participants

Distributions of benefits to participants can be made immediately after the participant's termination, or upon the participant's retirement, or to a beneficiary or an estate upon the participant's death. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or in the form of installments as defined in the plan agreement.

(e) Risks and Uncertainties

The Plan invests in various investment securities. These securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2010

occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of plan net assets.

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

(b) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) Investments

Investments are carried at fair value based upon quoted market prices at June 30, 2010, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury Bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of United States and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2010

Changes in plan net assets for the year ended June 30, 2010 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income (loss)	Transfers to/from related plan	Deductions	Internal transfers	Ending balance	Market value as a percentage of plan assets
Money market:								
Vanguard prime reserve	\$ 289,594	—	252	—	(62,158)	3,555	231,243	1.2%
Balanced:								
Vanguard Target Ret Inc	37,284	—	4,591	—	(13,525)	17,291	45,641	0.2
Vanguard Target Ret 2005	18,758	—	2,132	—	(90)	3,270	24,070	0.1
Vanguard Target Ret 2010	469,680	6,240	60,207	—	(9,207)	(8,366)	518,554	2.7
Vanguard Target Ret 2015	517,441	30,955	66,463	—	(3,406)	18,454	629,907	3.2
Vanguard Target Ret 2035	—	—	42	—	—	1,000	1,042	—
Vanguard Target Ret 2040	—	—	42	—	—	1,000	1,042	—
Vanguard Target Ret 2045	7,776	—	1,102	—	(90)	—	8,788	0.1
Vanguard Target Ret 2050	—	—	(18)	—	—	515	497	—
	<u>1,050,939</u>	<u>37,195</u>	<u>134,561</u>	<u>—</u>	<u>(26,318)</u>	<u>33,164</u>	<u>1,229,541</u>	<u>6.3</u>
Fixed return:								
Prudential	12,841,926	6,176,381	475,007	—	(3,560,077)	(198,793)	15,734,444	80.9
Fixed income:								
Vanguard Bond Market	241,321	7,920	23,070	—	(1,759)	(16,342)	254,210	1.3
Equity:								
Dodge & Cox Int Stock	82,945	—	10,513	—	(63)	4,978	98,373	0.5
Capital World Grth & Inc	32,239	—	1,958	—	(45)	13,093	47,245	0.2
Vanguard Ext Mkt Ind	131,881	23,492	34,504	—	(10,504)	12,534	191,907	1.0
Legg Mason Opp Trust	3,845	—	546	—	(60)	5,896	10,227	0.1
Legg Mason Cap Mgt	—	—	(74)	—	—	1,587	1,513	—
Growth Fund of America	110,330	—	7,876	—	(83)	89,195	207,318	1.1
Alliance Bern with App St	2,875	—	325	—	—	1,587	4,787	0.1
Mutual shares	286,395	9,060	47,367	—	(10,075)	(35,701)	297,046	1.5
Windsor II Adm	176,910	7,920	20,215	—	(6,998)	52,364	250,411	1.3
Vanguard Inst Index	216,140	—	26,737	—	(45,199)	5,649	203,327	1.0
Vanguard Total Int'l Stock	220,964	—	18,750	—	(11,332)	11,414	239,796	1.2
Vanguard Strategic Eq	—	—	(448)	—	—	15,820	15,372	0.1
	<u>1,264,524</u>	<u>40,472</u>	<u>168,269</u>	<u>—</u>	<u>(84,359)</u>	<u>178,416</u>	<u>1,567,322</u>	<u>8.1</u>
Total investments	15,688,304	6,261,968	801,159	—	(3,734,671)	—	19,016,760	97.8
Other plan net assets	407,710	24,840	(320)	—	—	—	432,230	2.2
Total plan net assets	<u>\$ 16,096,014</u>	<u>6,286,808</u>	<u>800,839</u>	<u>—</u>	<u>(3,734,671)</u>	<u>—</u>	<u>19,448,990</u>	<u>100.0%</u>

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2010

(5) Federal Income Tax Status

The Plan is a qualified plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated October 28, 2004. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

(6) Transfers from Related Plan

During the year, no assets were transferred into the Plan from the South Dakota Retirement System Supplemental Retirement Plan (SRP), a related plan. Transfers between SPP and SRP are allowed under state statutes.

(7) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants would continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

June 30, 2010



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Lincoln, NE 68508-2041

**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System
Special Pay Plan:

We have audited the financial statements of South Dakota Retirement System Special Pay Plan (the Plan) as of and for the year ended June 30, 2010, and have issued our report thereon dated November 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and management and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 22, 2010